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IN THE

Supreme Court of the United States

OCTOBER TERM 1984

UNITED STATES OF AMERICA,

Petitioner,

v.

AMERICAN COLLEGE OF PHYSICIANS,

Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

BRIEF FOR AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT, AMERICAN COLLEGE OF PHYSICIANS

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TABLE OF CONTENTS

	PAGE
INDEX OF AUTHORITIES	iii
QUESTION PRESENTED	vi
PRELIMINARY STATEMENT	1
INTEREST OF AMICUS CURIAE AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES	1
SUMMARY OF ARGUMENT	3
ARGUMENTS	4
I. Section 513 Does Not Create A Per Se Rule That Advertising Income Is Taxable	4
A. Section 513(a) Of The Internal Revenue Code Does Not Deem All Trades Or Businesses To Be Unrelated To The Exempt Purposes Of Nonprofit Organizations	4
B. Section 513(c) Provides A More Definite Definition Of The Term "Trade or Business" But Describes No Blanket Rule Regarding Any One "Unrelated" Trade or Business	6
C. The Meaning of Section 513(a) And Of Section 513(c) Is Plain From A Reading Of The Statute And An Examination Of The Legislative History Concerning These Sections Is Unwarranted	7
D. Section 513 Of The Internal Revenue Code Must Be Considered As A Whole And Not Interpreted Piecemeal	9
E. Section 513(c) Does Not Deal With The Subject of Advertising And The Title Of Section 513(c) Does Not Support The Conclusion That All Advertising Activity Amounts To An Unrelated Trade or Business	11

PAGE

F. Congress Has Failed To Adopt An Express Rule On The Advertising Income Of Exempt Organizations 12

G. The Government May Not Rely On The Views Of The Opponents Of Section 513(c) . 14

II. The Commercial Nature Of An Activity Is Not Determinative Of The Taxability Of That Activity Under Section 513 15

III. Example 7 Creates No Per Se Rule As To The Taxability Of Advertising 19

IV. Affirmation Of The Decision Below Will Not Impose Unnecessary Administrative Burdens 26

CONCLUSION 29

INDEX OF AUTHORITIES

PAGE

Cases

1. *Allen* v. *Grand Central Aircraft Company*, 347 U.S. 535 (1954) 10
2. *American Bar Endowment* v. *United States*, 761 F.2d 1573 (Fed. Cir. 1985), *petition for cert. filed*, 54 U.S.L.W. 3272 (U.S. Oct. 7, 1985) (No. 85-599) 16
3. *American College of Physicians* v. *United States*, 530 F.2d 930 (Ct. Cl. 1976) 8
4. *Bigelow* v. *Virginia*, 421 U.S. 809 (1975) 23
5. *Bolger* v. *Youngs Drug Products Corp.*, 463 U.S. 60 (1983) 23
6. *Brotherhood of Railroad Trainmen* v. *Baltimore and Ohio Railroad Company*, 331 U.S. 519 (1947) 11
7. *Bryant* v. *Yellen*, 447 U.S. 352 (1980) 14
8. *Caminetti* v. *United States*, 242 U.S. 470 (1917) 8
9. *Disabled American Veterans* v. *United States*, 560 F.2d 1178 (Ct. Cl. 1981) 16
10. *Harrison* v. *Northern Trust Company*, 317 U.S. 476 (1943) 9
11. *Helvering* v. *Wood*, 309 U.S. 344 (1940) 14
12. *Hi-Plains Hospital* v. *United States*, 670 F.2d 528 (5th Cir. 1982) 16
13. *In Re Public Bank of New York*, 278 U.S. 555 (1928) 9
14. *Louisiana Credit Union League* v. *United States*, 693 F.2d 525 (5th Cir. 1982) 16

PAGE

Cases

15. *Pacific Gas and Electric* v. *State Energy Resources Conservation and Development Commission*, 461 U.S. 190 (1983) 12

16. *Professional Insurance Agents of Michigan* v. *Commissioner*, 726 F.2d 1097 (6th Cir. 1984) . 16

17. *Sanford* v. *Commissioner of Internal Revenue*, 308 U.S. 39 (1939) 10

18. *United States* v. *Minker*, 350 U.S. 179 (1956) . 11

19. *United States* v. *Turkette*, 452 U.S. 576 (1981) 8

20. *Virginia State Board of Pharmacy* v. *Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748 (1976) 23

21. *Western Union Telegraph Company* v. *Lynn Root*, 323 U.S. 490 (1945) 14

STATUTES AND REGULATIONS

	PAGE
Internal Revenue Code of 1954 (26 U.S.C.)	
Section 513	*passim*
Section 513(a)	*passim*
Section 513(c)	*passim*
Treasury Regulation (26 C.F.R.)	
Section 1.513-1(a)	15, 17
Section 1.513-1(d)	17
Section 1.513-1(d)(2)	21, 26
Section 1.513-1(d)(4)(i) Example 3	18
Section 1.513-1(d)(4)(iv)	19
Example 3	19
Example 4	19
Example 5	18, 19, 24
Example 6	19, 20, 21
Example 7	*passim*
Miscellaneous:	
Rev. Rul. 73-104, 1973-1 C.B. 263	26, 28
Rev. Rul. 73-105, 1973-1 C.B. 264	27
S. Rep. No. 91-552, 91st Cong., 1st Sess. 75 (1969)	12, 13

QUESTION PRESENTED

Whether the income derived by a tax-exempt organization from the placement of advertising in the organization's publications is subject to taxation where such advertising, although it may be partly commercial in nature, contributes importantly to the accomplishment of the organization's tax-exempt purposes.

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PRELIMINARY STATEMENT

The American Society of Association Executives ("ASAE") submits this brief *amicus curiae* in support of the Respondent, American College of Physicians. All parties to this suit have given ASAE written consent to the filing of this brief. Copies of such consents have been filed with the Clerk of this Court.

INTEREST OF AMICUS CURIAE AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES

The American Society of Association Executives (ASAE) is a non-profit organization exempt from taxation under Section 501(c)(6) of the Internal Revenue Code. ASAE exists to promote the art and science of association management and to educate its members and the general public in the advancement,

improvement and uses of voluntary associations. The membership of ASAE is comprised primarily of full-time staff personnel engaged in the management of trade, professional, technical, educational, philanthropic or similar type organizations. ASAE has over thirteen thousand active members. ASAE has long been recognized as a leading speaker and advocate on association issues, particularly where, as in the present case, the ability of associations to function as educational and public spirited organizations is at stake.

A number of ASAE's 13,000 members are actively involved in managing associations that publish educational journals and many of those journals accept educational advertisements such as those which the Federal Circuit considered in the case below. ASAE also publishes several magazines that accept educational advertisements. ASAE's monthly publication, *Association Management*, is read by thousands of association executives and contains numerous articles and advertisements on good management techniques, effective tradeshow strategies, membership needs, changes within various professions, disciplines and industry groups, as well as relevant news on legal events concerning non-profit organizations.

Many association executives have been forced to forego the opportunity to assist their members in providing the most expansive and broad reaching educational information because of the restrictive interpretation of the non-profit advertising regulations used by the Internal Revenue Service. This interpretation has often been a factor in the decisions of many associations not to publish advertisements in their magazines and journals, even where it is clear that such advertisements would assist members in making intelligent choices and being more aware of issues and decisions with which they must deal in their work.

ASAE believes that its experience as a non-profit organization leader and its insight into the issues on certiorari will prove helpful in this case.

SUMMARY OF ARGUMENT

Section 513 of the Internal Revenue Code provides a definitional framework whereby a distinction can be drawn between those trades or businesses conducted by nonprofit organizations which are substantially related to the organization's exempt purposes and, therefore, not subject to taxation, and those trades or businesses which are not substantially related and, therefore, are subject to taxation. Contrary to the government's contention, Section 513(c) does not set forth a per se rule that particular trades or businesses must be deemed "unrelated." Rather, Section 513(c) establishes a "fragmentation principle" under which a particular activity will not automatically be deemed to be "related" merely because it is carried on within the context of an overall activity which is related to exempt purposes.

Section 513 is clear on its face and its plain meaning is that the determination as to whether a given trade or business is or is not substantially related to exempt purposes is a determination which must be made based on the facts and circumstances of each case. Even if resort is had to the legislative history underlying the amendment of Section 513(c) in 1969, that legislative history does not support the proposition that Congress intended to make it clear that *all* advertising appearing in journals published by tax-exempt organizations is subject to taxation.

The "commercial" nature of an activity is not dispositive of the taxability of that activity under Section 513. For an activity to be subject to the unrelated business income tax, there must be a determination that the activity is (1) a trade or business, (2) regularly carried on, (3) which is not substantially related to the exempt purposes of the organization conducting the activity. The "commercial" nature of an activity is important in determining whether the activity is a "trade or business" but is not a controlling factor in determining whether the activity is substantially related to exempt purposes.

Example 7 under the Internal Revenue Service regulations does not establish a per se rule that all advertising appearing in an exempt organization's publications is subject to taxation and

Example 7 is inapplicable to the facts in the case at bar. Example 7 deals with "ordinary commercial advertising" which merely proposes a commercial transaction, whereas the advertising in the instant case has a significant informational and educational component which differentiates it from the advertising considered in Example 7. Example 7 does not mandate the taxation of advertising if the educational function of such advertising contributes importantly to exempt purposes.

Affirmance of the decision below will impose no administrative burdens which do not already exist in regard to the unrelated business income tax. The Internal Revenue Service long has recognized that the peculiarities of the unrelated business income tax frequently require the examinination of an exempt organization's sales activities on a category-by-category basis. A requirement that the Service examine advertising on a similar basis is fully in conformity with the law and regulations.

ARGUMENTS

I. SECTION 513 DOES NOT CREATE A PER SE RULE THAT ADVERTISING INCOME IS TAXABLE

A. Section 513(a) Of The Internal Revenue Code Does Not Deem All Trades Or Businesses To Be Unrelated To The Exempt Purposes Of Nonprofit Organizations.

Section 513(a) of the Internal Revenue Code states as follows:

> (a) *General Rule.* — The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by Section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 (or, in the case of an organization described in section 511(a)(2)(B), to the exercise or per-

formance of any purpose or function described in section 501(c)(3)), except that such term does not include any trade or business. —

(1) in which substantially all the work in carrying on such trade or business is performed for the organization without compensation; or

(2) which is carried on, in the case of an organization described in section 501(c)(3) or in the case of a college or university described in section 511(a)(2)(B), by the organization primarily for the convenience of its members, students, patients, officers, or employees, or, in the case of a local association of employees described in section 510(c)(4) organized before May 27, 1969, which is the selling by the organization of items of work-related clothes and equipment and items normally sold through vending machines, through food dispensing facilities, or by snack bars, for the convenience of its members at their usual places of employment; or

(3) which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

Section 513 of the Internal Revenue Code is definitional in nature and has two applications. The first application is to trades or businesses the conduct of which are not substantially related to the exercise or performance by an organization of its charitable, educational, or other purposes or functions constituting the basis for its exemption. The second application of Section 513 is to those activities which *are* substantially related to the exempt functions of an organization.

A plain reading of Section 513(a) reveals that the express intent of this section is to allow certain trades or businesses to be considered related to the purposes of an exempt organization *regardless* of the type of commercial activity involved. The application of Section 513(a) cannot therefore be disputed: if an organization conducts a trade or business related to the exempt purposes of the organization, no matter the commercial character

of or income from the activity, such trade or business will not be a taxable activity. Because of Section 513's plain meaning it is obvious that in enacting Section 513, Congress did not mean to delineate any specific type of trade or business as being an "unrelated trade or business" in all cases. Rather, it meant only to tax the income of trades or businesses which are unrelated to an organization's exempt purposes by virtue of their failure to meet the requirements under Section 513(a). Ultimately, therefore, a fact question arises in each case as to whether or not a trade or business of an organization meets the substantially related definition contained in Section 513(a).

Section 513(a) also contains three subparagraphs which allow for certain activities to be considered exempt trades or businesses. All that is required for one of these three exceptions to apply is that: (1) substantially all the work in carrying on such trade or business be performed for the organization without compensation; (2) the activity be carried on for the convenience of members, students, patients, officers, or employees; (3) merchandise be sold which has been donated to an organization as gifts. These three subparagraphs of Section 513(a) are further evidence that Congress intended to create numerous exceptions for the taxation of certain commercially oriented activities carried on by exempt organizations. Nowhere in Section 513(a) is this principle controverted.

B. Section 513(c) Provides A More Definite Definition Of The Term "Trade Or Business" But Describes No Blanket Rule Regarding Any One "Unrelated" Trade Or Business

Section 513(c) of the Internal Revenue Code states as follows:

> (c) *Advertising, Etc., Activities.* — For purposes of this section, the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services. For purposes of the preceding sentence, an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger com-

> plex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit.

In enacting Section 513(c) of the Code, Congress essentially codified what has become known as the "fragmentation approach" employed by the Internal Revenue Service in determining the taxable portion of income which is derived by a tax-exempt organization when it engages in an unrelated business activity as a part of an overall activity which is in furtherance of exempt purposes. This approach is used where a publication has both tax-exempt and non-exempt features. Thus, the editorial content of a tax-exempt publication would be an exempt function, but the advertising in the publication (provided it is not substantially related to the exempt organization's purposes) could be a taxable activity. Congress did not, by the terms of Section 513(c), intend to designate any one activity, such as advertising, as an unrelated trade or business. Rather, Section 513(c) serves only to allow for a closer examination of certain activities undertaken by an exempt organization. One examination is for editorial content and another examination is for any trade or business which might be unrelated to the exempt purposes of the organization. Nowhere in Section 513(c) is there a requirement that all advertising income of a tax-exempt publication be considered a trade or business unrelated to an organization's exempt purposes.

C. The Meaning of Section 513(a) And Of Section 513(c) Is Plain From A Reading Of The Statute And An Examination Of The Legislative History Concerning These Sections Is Unwarranted.

The Federal Circuit in the decision below undertook an examination of Section 513(a) and Section 513(c) to determine whether or not the advertising income realized by the American College of Physicians was unrelated to that organization's exempt purposes. This the Court was required to do by the plain meaning of Section 513(a) and of Section 513(c). The Federal Circuit found no need to resort to the legislative history of the statute, as

has the counsel for the Government, because the meaning of the statute and, for that matter, the regulations thereunder, is plain and clear. The United States Supreme Court has held in many cases that

> the meaning of the statute must, in the first instance, be sought in the language in which the act is framed, and if that is plain, . . . the sole function of the Court is to enforce it according to its terms.

Caminetti v. *United States*, 242 U.S. 470 (1917).

Thus, where the language of a statute is

> plain and admits of no more than one meaning the duty of interpretation does not arise and the rules which are to aid doubtful meanings need no discussion.

Id.

The result reached below is entirely consistent with the plain meaning of Section 513(a) and of Section 513(c). The history of the application of Section 513(a) and Section 513(c) as to advertising income is a history of factual disputes between the government and private parties as to whether or not certain advertising activities are substantially related to an organization's exempt purposes. The factual nature of the application of Sections 513(a) and 513(c) was recognized by the United States Court of Claims in *American College of Physicians* v. *United States*, 530 F.2d 930 (Ct. Cl. 1976), where it noted that the educational value of advertisements appearing in the *Annals of Internal Medicine* was an "essentially factual dispute." 530 F.2d at 930. Because it is clear that the statute requires a facts and circumstances test to determine whether an activity such as advertising is to be considered related to an organization's exempt purposes, the government's reliance on the legislative history of Section 513(c) is unwarranted and invalid. In *United States* v. *Turkette*, 452 U.S. 576 (1981), this Court held that if statutory language is unambiguous, in the absence of a clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive. The contrary legislative intent is missing in this case because

had Congress intended to create in Section 513(c) a blanket rule regarding advertising income, it would have done so. Sections 513(a) and (c) cannot be any more unambiguous than they are.

The Federal Circuit examined the facts surrounding the advertising activities of the American College of Physicians as it was required to do under Section 513(a). The Federal Circuit was aware of the application of Section 513(c) but concluded, rightly so, that Section 513(c) does not automatically label as an "unrelated trade or business" every advertising activity of an association. Section 513(c) does not say this and any conclusion that it does so is unwarranted. In enacting Section 513(c), Congress expressly allowed for the conclusion reached by the Federal Circuit because it in no way altered Section 513(a) nor did it state in Section 513(c) that all advertising activities are to be considered unrelated trades or businesses. Section 513(c), as it indicates on its face, does no more than provide a guide as to when an activity will be considered a trade or business. It does not diminish the "substantially related" exceptions contained in Section 513(a).

D. Section 513 Of The Internal Revenue Code Must Be Considered As A Whole And Not Interpreted Piecemeal

The approach by the government in this case is one which could detach Section 513(c) from the rest of the statute (i.e., from Section 513(a)) and read into Section 513(c) a number of unsupported conclusions. One such unsupported conclusion is that the statute was intended to operate as a "per se" rule with regard to the unrelated trade or business character of advertising activities by nonprofit organizations. It has long been a rule of statutory construction that each part or section of a statute should be construed in connection with every other part or section so as to produce a harmonious whole. *In Re Public Bank of New York*, 278 U.S. 555 (1928). It is not proper to confine interpretation to the one section to be construed. *Harrison* v. *Northern Trust Company*, 317 U.S. 476 (1943). It is, therefore, an incorrect assumption on the part of the government that the proper way to construe Section 513(c) is in an isolated fashion without any

reference to the exceptions contained in Section 513(a). Nothing in Section 513(c) demands, at least on the face of the statute itself, that this section be construed alone. The decision of the Federal Circuit below is within the letter and spirit of the entire Section 513 of the Internal Revenue Code when it concludes that

> Section 513(a) expressly requires that, although considered a separate trade or business, the conduct of that advertising must be evaluated to determine whether it is not substantially related to an exempt purpose or function of the organization and to determine whether the conduct of the trade or business is not primarily for the convenience of the organization's members, before that income is taxable.

743 F.2d 1570 at 1575. Certainly, a reading of Section 513(c) does not lead one to conclude that if an advertising activity is to be considered a trade or business under Section 513(c) one may not at the same time inquire under Section 513(a) as to whether or not the activity is nonetheless substantially related to the exempt purposes of the organization.

If Section 513(c) is properly considered as an amendment to Section 513 of the Code, the new provision should be presumed in accordance with the legislative policy embodied in the prior statute. *Allen* v. *Grand Central Aircraft Company*, 347 U.S. 535 (1954). Thus, the two statutes should be construed together. *Sanford* v. *Commissioner of Internal Revenue*, 308 U.S. 39 (1939). If the two statutes are construed together, then the legislative policy embodied in the plain language of the statute becomes clear: An examination is required of all trades or businesses to determine whether or not they are substantially related to an organization's exempt purposes. If such activities are not so related, they will result in unrelated business taxable income. If they are so related, they will not result in unrelated business taxable income. The statute as well as the regulations, require this type of analysis.

E. Section 513(c) Does Not Deal With The Subject Of Advertising And The Title Of Section 513(c) Does Not Support The Conclusion That All Advertising Activity Amounts To An Unrelated Trade Or Business

Section 513(c) of the Internal Revenue Code is entitled "Advertising, Etc., Activities." The activity of advertising is mentioned only in the title and does not appear anywhere in Section 513(c) itself. It is therefore clear that the section was actually meant to apply to a number of activities and not just to advertising. It cannot be argued, therefore, that Section 513(c) was enacted only to deal with advertising as either a related or unrelated trade or business. The government cannot rely simply on the title of this section to argue that advertising is to be considered an unrelated trade or business in all cases. *United States* v. *Minker*, 350 U.S. 179 (1956), for example, holds that although the title is part of a statute, it may not be used as a means of creating an ambiguity when the body of the act itself is clear. *See also*, *Brotherhood of Railroad Trainmen* v. *Baltimore & Ohio Railroad Company*, 331 U.S. 519 (1947), holding that the title of a statute or the *heading of a section* are of use for interpretive purposes only when they shed light on some ambiguous word or phrase, and cannot limit the plain meaning of the text. If the government were allowed to prevail on its claim that Section 513(c) operates as a per se rule on the disposition of all advertising income, then it would be adding something to the statute based only upon the title of Section 513(c). The addition urged by the government clearly has no place in Section 513, as can be seen by the language in Section 513(a). As the Federal Circuit held in the decision below, even if Congress did intend to tax all advertising revenues of all journals of exempt organizations through Section 513(c),

> it failed to carry that alleged intent forward into the statute with language appropriate to affect that result.

743 F.2d at 1575. The title of Section 513(c) suggests only that advertising is one of the activities that does not lose its identity as a trade or business simply because it is part of a larger exempt

activity. To expand Section 513's meaning beyond this would be to go outside the plain meaning of the statute.

F. Congress Has Failed To Adopt An Express Rule On The Advertising Income Of Exempt Organizations

Congress had the chance in 1969 to enact a provision which would have taxed all advertising income of exempt organizations. Congress did not do this, however, but instead chose only to adopt the Treasury Department regulation which acted to fragment the analysis of income from non-profit publications. Nothing in what Congress enacted in 1969 requires anything more than the examination of an advertising activity to see if it meets the tests set out in Section 513(a). While this Court has been reluctant to draw certain conclusions from the failure of Congress to act, it is nevertheless, irrelevant for the government to urge the court to give a reading to statutory language that Congress has considered and rejected. *Pacific Gas and Electric* v. *State Energy Resources Conservation and Development Commission*, 461 U.S. 190, 220 (1983). ASAE urges that this Court need not examine the legislative history of Section 513(c) because of the plain meaning and lack of ambiguity in the entire Section 513. Nevertheless, if the court does investigate the legislative history of Section 513(c), it will see that Congress was given ample opportunity to enact just the type of statute which the government now claims exists in current Section 513(c) — i.e., one which would conclusively presume all income from advertising activities by tax-exempt organizations to be taxable. This Congress refused to do. The legislative history is replete with instances where advertising activities could have been dealt with in a more detailed manner than is currently the case. For example, at one point during the legislative process, the Senate Finance Committee attempted to include specific language regarding advertising within Section 513(c). Although this specific language would not have adopted the per se rule which the government now urges, it would have dealt with advertising in a more specific vein. The report of the Senate Finance Committee, November 21, 1969, states:

> The Committee amendments approve the intent of the House provision, but restructure the language of the

> provision so that it will apply only in the case of advertising and certain other profit-making activities carried on within a larger aggregate of activities . . .

S. Rep. No.91-552, 91st Cong., 1st Sess. 75 (1969). The language which the Senate Finance Committee wanted to include in Section 513(c) is as follows:

> (c) *Advertising, Etc., Activities.* — For purposes of this Section the term 'trade or business' includes the following activities carried on for the production of income:
>
> (1) the publication of advertising in any magazine, newspaper, periodical, or other publication, for the dissemination of advertising by radio or television broadcasts, . . .

Even if the above provision drafted by the Senate Finance Committee had been included within Section 513(c), it still would not have amounted to a per se rule stating that all advertising income of tax-exempt organizations shall conclusively be presumed to be unrelated trade or business income. Rather, the language suggested by the Senate Finance Committee would only have indicated that advertising is one of the activities which does not lose its character as a trade or business merely because it is carried on in conjunction with the publication of a tax-exempt magazine or newsletter. The test in Section 513(a), that of substantiality, would still apply.

This means that, though Congress had the chance to pass a per se rule which would have definitely characterized all advertising income as unrelated trade or business income, it failed to do so and indeed did not want to do so. The closest Congress came to a rule on advertising and advertising alone came from an attempt by the Senate Finance Committee to define the parameters of Section 513(c) so as to specifically apply to advertising and a few other select activities. As we have seen, however, even that attempt would not have engendered the result now urged by the government — that of a per se rule casting all advertising income as unrelated trade or business income.

Because of the Congressional action, or, perhaps inaction, with regard to this issue, a court would be well within its rights in interpreting Section 513 to mean that Section 513(a) allows for defining advertising income as "related" income if it is from an activity that is substantially related to the exempt purposes of an organization. There is simply no way for the government to refute this fact.

G. The Government May Not Reply On The Views Of The Opponents Of Section 513(c)

Again, ASAE stresses that legislative history is not relevant and should not be decisive in this case. However, it cannot be ignored that Congress failed to enact the law which the government claims has been enacted in Section 513(c) and, though Congress conducted hearings on this law and heard many witnesses, the law which emerged from the legislative process does not embody the recommendations of many of the witnesses at the legislative hearings. It may thus be inferred that Congress has chosen to reject the position of many of the witnesses at those hearings. See, *Helvering* v. *Wood*, 309 U.S. 344 (1940). In *Helvering* this Court held that where Congress, in enacting a law, has acted specifically only on one of two recommendations, this is indicative that the language of the specific provision must be taken at its face value only. See also, *Western Union Telegraph Company* v. *Lynn Root*, 323 U.S. 490 (1945), holding that to translate a statute, by a process of interpretation, into an equivalent of bills rejected by Congress is beyond the fair range of interpretation.

There is another reason why the legislative history argument advanced by the government is suspect. In its brief the government relies heavily upon testimony of witnesses who opposed the enactment of Section 513(c). Brief of United States at 19-20. The government's discussion of the position of the opponents of the Treasury regulation and any law codifying the Treasury regulation is not entitled to any weight in considering the Congressional intent underlying Section 513(c). Statements by the opponents of a bill are not the most reliable indications of Congressional intent. See, *Bryant* v. *Yellen*, 447 U.S. 352 (1980). ASAE believes, in

any case, that the legislative history of Section 513, as it pertains to the government's argument is irrelevant since Section 513(c) does not do what the government claims it does or what some of the witnesses at the legislative hearings wanted it to do. It does not create a blanket definition requiring that all advertising income from exempt organization publications be considered unrelated trade or business income.[1]

II. THE COMMERCIAL NATURE OF AN ACTIVITY IS NOT DETERMINATIVE OF THE TAXABILITY OF THAT ACTIVITY UNDER SECTION 513

In essence, the government contends that if an activity is *commercial* in nature, then the activity cannot be related to exempt purposes so as to avoid the unrelated business income tax. This contention conflicts with the statute, the regulations and established case law. The *commercial* nature of an activity is relevant to the inquiry as to whether the activity constitutes a "trade or business" but it is not dispositive as to the taxability of the activity.

In determining whether an activity engaged in by a tax-exempt organization is subject to the unrelated business income tax, Treasury Regulation Section 1.513-1(a) sets forth three elements which must be established: the activity must be (1) a trade or business within the meaning of section 162 of the Internal

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[1] Nor does the government's reference to the statements of many commentators on the Internal Revenue Service Regulations and the 1969 legislation provide support for the government's position. While the goverment contends that these commentators opined that the regulations and the 1969 amendment to Section 513(c) created a rule that all advertising income would be taxable, close analysis of the articles referenced by the government demonstrates that such was not the thrust of the commentators' analysis. Rather, those articles focused on the unique theory of the "fragmentation principle" (and the computational problems caused thereby) which posited that one business activity could be fractionalized into taxable and non-taxable components. The articles focus on the difficulty of applying the "fragmentation principle" and, in using advertising in an exempt publication as an example, *assume* that the advertising will be taxable in order to examine the computational acrobatics required to differentiate taxable and non-taxable income where a distinct activity generates both types of income.

Revenue Code; (2) which is regularly carried on; and (3) which is not substantially related to the exempt function of the organization. This three-part test has been adopted and recognized by the courts and was recognized by the court below. See, *Professional Insurance Agents of Michigan* v. *Commissioner*, 726 F.2d 1097, 1102 (6th Cir. 1984); *Louisiana Credit Union League* v. *United States*, 693 F.2d 525, 531 (5th Cir. 1982); *Hi-Plains Hospital* v. *United States*, 670 F.2d 528, 530 (5th Cir. 1982).

As to the first test — whether or not an activity constitutes a "trade or business" — the courts have established two criteria. The activity will constitute a "trade or business" where it is engaged in with a "profit motive," *Professional Insurance Agents, supra; Louisiana Credit Union League, supra,* and/or where the activity is conducted in a "competitive, commercial manner." *American Bar Endowment* v. *United States*, 761 F.2d 1573 (Fed. Cir. 1985), *petition for cert. filed*, 54 U.S.L.W. 3272 (U.S. Oct. 7, 1985) (No. 85-599); *Disabled American Veterans* v. *United States*, 560 F.2d 1178 (Ct. Cl. 1981).

In the instant case, the parties stipulated that the advertising at issue constituted a "trade or business" which was regularly carried on. Therefore, the government was not required to establish that the advertising activity of the American College of Physicians met the first two tests under the regulations. The only issue was whether the advertising met the third test, that the advertising activity was not substantially related or did not contribute importantly, to the exempt purposes of the College.

In attempting to satisfy this test, the government has confused the criteria applicable to the first and third tests under the regulations and has utilized the criteria of the first test to establish that the third test is met. By focusing on the fact that the advertising activity of the College was engaged in for the production of income and was conducted in a "competitive, commercial manner" (the criteria applicable to establishment of the first test — "trade or business"), the government has confused the issue and seeks to create a rule which is not justified by the statute or the regulations thereunder.

Throughout its brief, the government argues that the only relevant inquiry is whether the advertising activity is commercial and contends that, if the activity is found to be a commercial in nature, then the activity must be held subject to tax.[2] The government's contention is in conflict with the statute and the regulations since it fails to recognize that all three tests must be satisfied before an activity may be subjected to taxation. Under the government's approach, *any* trade or business regularly carried on by a tax-exempt organization would be subject to the unrelated business income tax; the third test (unrelatedness) is ignored. Acceptance of the government's contention would require the invalidation or intentional refusal to acknowledge the plain language of the statute and the regulations.

Section 513(a) of the Internal Revenue Code expressly defines an "unrelated trade or business" as "any trade or business the conduct of which is not substantially related . . . to the exercise or performance by such organization of its charitable, educational, or other purpose or function . . . " This language is repeated in Treasury Regulation Section 1.513-1(a). Treasury Regulation Section 1.513-1(d) defines the meaning of "substantially related" and provides that a trade or business will be so related if it "contribute[s] importantly to the accomplishment of [exempt] purposes."

Under the government's methodology, the "only relevant inquiry" is whether the activity in question is "commercial." If the answer to that inquiry is in the affirmative, then (according to the government) no further inquiry is necessary — the activity is per se deemed to be an unrelated trade or business. Under the test proposed by the government, none of the examples set forth in the regulations, in which income is determined to be exempt from the

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[2] "Under the Regulation . . . , the only relevant factual question is whether respondent's advertising is *commercial* publicity . . . " Brief for the United States at 10 and 30. (Emphasis in original). The Treasury and IRS examiners have reviewed advertisements in tax-exempt journals under an established approach "that *commercial* advertising is unrelated per se to exempt purposes . . . " *Id.* at 42. (Emphasis in original).

unrelated business income tax, would be correct interpretations of the statute.

In Treasury Regulation Section 1.513-1(d)(4)(i), Example (3), for instance, it is stated that the income received by an industry trade association from rental charges and admission fees in connection with a trade show will not be subject to taxation. According to the Example, the purpose of the trade show "is the promotion and stimulation of interest in, and demand for, the industry's products in general . . . " The exhibitors at the trade show rent display space in order to "advertise" their products and services and pay the trade association sponsor for the use of such display space. The Example concludes that the payments to the trade association are not unrelated business income. Under the test proposed by the government in the instant case, however, the opposite conclusion would have to be reached. Under the facts in Example (3), it is clear that the trade show is "commercial" in nature and, under the government's test, the commercial nature of that activity would foreclose an inquiry as to whether the activity contributed importantly to the exempt purposes of the trade association. Therefore, the trade show income would be subject to taxation.

A similar result would be mandated in regard to the facts set forth in Treasury Regulation Section 1.513-1(d)(4)(iv), Example (5). In that example, an exempt university provides for the publishing of a campus newspaper by the students. The newspaper publishes paid advertising which is solicited, sold and published by the students. The Example states that "the services rendered to advertisers are of a commercial character;" nevertheless, the Example concludes that the advertising revenues are not subject to taxation since "the advertising business contributes importantly to the university's educational program through the training of the students involved." Under the test advocated by the government in the instant case, the "commercial character" of the advertising would render the advertising income per se taxable.

Thus, the flaw in the government's contention is obvious. The commercial character of an activity, standing alone, cannot be determinative of the taxability of the activity. The commercial character of the activity merely provides guidance as to whether the activity is a "trade or business" which *may* be subject to taxation. If the commercial character of the activity is sufficient to constitute the activity as a trade or business, then the inquiry must be made as to whether the activity contributes importantly to exempt purposes. Only the answer to the latter inquiry can be dispositive as to the taxability of the activity.

III. EXAMPLE 7 CREATES NO PER SE RULE AS TO THE TAXABILITY OF ADVERTISING INCOME

The government contends that Example 7, appearing in Treasury Regulations Section 1.513-1(d)(4)(iv), represents a per se rule that *all* advertising appearing in *all* tax-exempt publications is subject to the unrelated business income tax. The government's interpretation of Example 7, however, suffers from the same flaw which invalidates the government's construction of the statutory language, i.e., that if an activity is commercial in nature then the activity must be deemed subject to taxation. Assuming that Example 7 is valid (an issue which your amicus does not concede), the Example only stands for the proposition that ordinary, commercial advertising is subject to taxation.

As was pointed out in the previous argument, the mere commercial nature of advertising is not dispositive as to whether the advertising is subject to taxation. In each instance, the advertising must be scrutinized to ascertain whether the advertising "contributes importantly" to the accomplishment of exempt purposes; if it does, then the advertising will not be subject to taxation. The regulations contain five examples which involve advertising, Treasury Regulation Section 1.513-1(d)(4)(iv), Examples (3), (4), (5), (6) and (7), and as previously has been demonstrated, one of those examples concludes that the advertising is not subject to taxation. Example (5). The very fact that one of the advertising examples reaches that conclusion refutes the government's contention that Section 513(c) of the Internal Revenue Code represents a "blanket" or "per se" rule that all advertising is subject to

the unrelated business income tax. The examples are set forth to establish the operation and application of the "fragmentation principle," not to establish the taxability of *all* advertising.

Examples (6) and (7) concern the tax treatment of advertising appearing in magazines published by tax-exempt organizations. In both examples, it is conceded that the articles and editorial content of the magazines contribute importantly to the exempt purposes of the publishing organization; therefore, the circulation income is not subject to taxation. To demonstrate the application of the fragmentation principle, however, the Examples go on to analyze the taxability of the advertising appearing in the magazines.

In Example (6), the advertising consists of "general consumer advertising, including advertising of such products as soft drinks, automobiles, articles of apparel, and home appliances." The Example concludes that the revenue earned from the sale of such advertising will be subject to taxation because "[n]either the publication of such advertisements nor the performance of services for such commercial advertisers contributes importantly to the accomplishment of any purpose for which exemption is granted." This latter conclusion is stated as a conclusary matter of fact and, to that extent, the Example is flawed. As pointed out above, the key inquiry is whether the activity under scrutiny "contributes importantly" to exempt purposes. The resolution of that inquiry requires a finding of fact. If there is a finding of fact that an activity does not contribute importantly to exempt purposes, then, as a matter of law, the activity will be subject to taxation. Although the analysis in Example (6) is flawed by the inclusion of a conclusory finding of fact, it is clear that the advertising described therein does not contribute importantly to exempt purposes.

The flaw in the example highlights, however, the same flaw in the government's argument. The government contends that all advertising is commercial in nature and, therefore, that advertising cannot contribute importantly to exempt purposes. In other words, the government seeks to establish an irrebuttable presumption that advertising is unrelated to exempt purposes and,

thereby, to establish *as a fact* that all advertising is taxable. The Court below recognized that such a factual presumption and conclusion was unwarranted under the statutory language and contrary to the directives of the regulations: "whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the *facts and circumstances involved*." Treasury Regulation Section 1.513-1(d)(2). (Emphasis added). A sensitivity to the importance of the factual inquiry in determining whether an activity is "substantially related" is required in order to understand why Example (7) is not dispositive in the instant case.

Example (7) states that it is based on the same facts as those set forth in Example (6) "except that the advertising in Z's journal promotes only products which are within the general area of professional interest of its members." There are, however, several additional facts set forth in regard to the nature of the advertising and, as in Example (6), a conclusory factual statement as to the "relatedness" of the advertising. It is that conclusory factual statement which differentiates Example (7) from the case at bar and other similar advertising activities of tax-exempt organizations. The "factual" matters discussed in Example (7) are set forth below:

> Following a practice common among taxable magazines which publish advertising, Z requires its advertising to comply with certain general standards of taste, fairness, and accuracy; but within those limits the form, content, and manner of presentation of the advertising messages are governed by the basic objective of the advertisers to promote the sale of the advertised products. While the advertisements contain certain information, the informational function of the advertising is incidental to the controlling aim of stimulating demand for the advertised products and differs in no essential respect from the informational function of any commercial advertising. Like taxable publishers of advertising, Z accepts advertising only from those who

> are willing to pay its prescribed rates. Although continuing education of its members in matters pertaining to their profession is one of the purposes for which Z is granted exemption, the publication of advertising designed and selected in the manner of ordinary commercial advertising is not an educational activity of the kind contemplated by the exemption statute; it differs fundamentally from such an activity both in its governing objective and in its method.

Of particular note is the statement that "the informational function of the advertising is incidental to the controlling aim of stimulating demand for the advertised products *and differs in no essential respect from the informational function of any commercial advertising*." (Emphasis added).

Thus, the advertising in Example (7) contains only that information which would be present in ordinary commercial advertising directed to the general public. Such is not the case in regard to the advertising at issue in the instant case. The advertising in the instant case serves an "informational function" far different from that of "any commercial advertising," for the advertisements in the instant case present detailed and comprehensive information in regard to the products which are being advertised, information which would not be included in "ordinary commercial advertising."

It is this crucial distinction which the government fails to grasp or, possibly, deliberately prefers to eschew. Neither the Respondent nor your amici contend that "ordinary commercial advertising" (such as that involved in Example 7) is exempt from taxation. Rather, we contend that where advertising has a significant informational and educational component which contributes importantly to a nonprofit organization's exempt purposes and functions, then such advertising is not subject to taxation.

The distinction between "ordinary commercial advertising" and advertising which, although partly commercial in nature, contains significant educational information is precisely the distinction which was recognized by the court below. This Court

also, in its "commercial speech" cases, has recognized that there are gradations of commercial speech. On the one hand, there is "pure" commercial speech (something akin to "ordinary commercial advertising") which is represented by advertising which does no more than propose a commercial transaction; on the other hand, there are other types of commercial speech or advertising which go beyond the mere proposal of a commercial transaction and provide the recipients of the advertising with valuable information. *Virginia State Board of Pharmacy* v. *Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748 (1976); *Bigelow* v. *Virginia*, 421 U.S. 809 (1975). In the context of determining whether speech is commercial or non-commercial for the purpose of ascertaining the amount of First Amendment protection to which the speech is entitled, this Court has stated: "The mere fact that [printed materials] are conceded to be advertisements clearly does not compel the conclusion that they are commercial speech. Similarly, the reference to a specific product does not by itself render the [printed materials] commercial speech. Finally, the fact that [the publisher] has an economic motivation for [publishing] the [printed materials] would clearly be insufficient by itself to turn the material into commercial speech." *Bolger* v. *Youngs Drug Products Corp.*, 463 U.S. 60, 66-7 (1983) (citations and footnote omitted). Thus, this Court has recognized that commercial advertising can have differing levels of informational value and that the legal treatment and informational content of advertising is to be considered separately from the economic or commercial motivation of the publisher. Advertising may perform the function of providing the recipient with important and educational information, just as the advertising in the instant case does.

Your amicus does not mean to suggest that the same tests which this Court has utilized to distinguish commercial speech from noncommercial speech are directly applicable to the case at bar. In the context of distinguishing commercial speech from noncommercial speech, this Court has been concerned with the amount of First Amendment protection to which such speech was entitled. That is a far different question from the question posed in the instant case. This case does not involve constitutional

issues; it merely involves interpretation of a section of the Internal Revenue Code. Our reference to the "commercial speech" cases is solely for the purpose of demonstrating this Court's recognition of the fact that advertising can serve a function separate and apart from the mere proposal of a commercial transaction. Once it is understood that advertising can serve other than commercial purposes, then it is possible to perceive the manner in which advertising, such as that in the instant case, can serve the exempt purposes of a nonprofit organization by providing educational information.

As previously noted, in Example (7) of the regulations, it is stated as a fact that the advertising described in that example has an informational function which "differs in no essential respect from the informational function of any commercial advertising." With that factual predicate, the Example goes on to state that "the publication of advertising designed and selected in the manner of *ordinary commercial advertising* is not an educational activity of the kind contemplated by the exemption statute." Your amicus has no quarrel with this statement, standing alone. "Ordinary commercial advertising" is subject to the unrelated business income tax. Advertising, such as that in the instant case, however, is *not* "ordinary commercial advertising."

The advertising in the instant case does not consist solely of an invitation by the advertiser to the reader to purchase a particular product or service. Rather, it alerts the reader to the existence of specified products and services and, further, provides the reader with an extensive amount of information as to those products and services. Thus, advertising such as that in the instant case is not "designed and selected in the manner of ordinary commercial advertising" and, therefore, its taxability is not governed by Example (7).

Moreover, due heed must be paid to the manner in which the advertising contributes importantly to the accomplishment of exempt purposes. In Example (5) under the regulations, the commercial advertising business engaged in by a campus newspaper was held to contribute "importantly to the university's educational program through the *training* of the students involved." The American College of Physicians, as well as many other

organizations exempt from taxation under section 501(c)(3) and 501(c)(6), has among its exempt purposes the education of its members and the advertising, which appears in the journals sent to those members, may serve those educational purposes to the same extent that the campus newspaper's advertising business assists in the education and training of students. Obviously, the presentation of "ordinary commercial advertising" will not serve to accomplish the educational purposes of a 501(c)(3) or 501(c)(6) organization. Where, however, the advertising pertains to products and services of professional interest to the members of those organizations and contains particularized information, which normally would not be included in advertising of the same products and services when directed to the general public, then such advertising has two distinct aspects and functions. It provides a commercial message and it serves to provide the readers with significant educational information which will assist them in their professions. As the court below held, if the educational function of such advertising contributes importantly to exempt purposes, then the commercial nature of the medium in which the information is conveyed will not require imposition of the unrelated business income tax.

The advertising considered in Example (7) differed "in no essential respect" from "any commercial advertising." The advertising in the instant case and the advertising contained in the publications of many other non-profit organizations does differ from ordinary commercial advertising. It contains details and information which would not be included in advertising directed to the general public and it serves an important educational function in alerting the readers to, and keeping them advised of, information which is useful to them in their professions. Thus, this type of advertising contributes importantly to the accomplishment of exempt purposes and is substantially related to those purposes. As a result, such advertising is different from that considered in Example (7) and is not subject to the unrelated business income tax.

IV. AFFIRMATION OF THE DECISION BELOW WILL NOT IMPOSE UNNECESSARY ADMINISTRATIVE BURDENS

The government contends that affirmance of the decision below will impose "formidable burdens on IRS audit resources" since IRS examiners no longer will be able to rely on a per se rule that *all* advertising is taxable. Brief for United States at 42. According to the government, "IRS examiners were not required to investigate the 'educational' function of advertisements on an ad-by-ad basis," in the past. *Id.* If, indeed, that is true, the only result of affirmance in the instant case would be a requirement that IRS examiners administer the tax laws in accordance with statutory language, rather than relying on an arbitrary rule which is not supported by law.

The government further complains that the court of appeals "has provided no workable standard" by which to assess the taxability of advertising activities. Such, however, is not the case. The standard applied by the court of appeals is exactly that mandated by the statute and the regulations. If advertising activity is determined to be a trade or business which is regularly carried on, then the advertising must be analyzed to determine whether it is "substantially related" or "contributes importantly" to the exempt purposes of the publishing organization. Administration of this standard may well require determination on a case-by-case basis, but there can be no other result where a tax law is to be applied on a "facts and circumstances" basis, and the regulations specifically provide that the determination of "[w]hether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved." Treasury Regulation Section 1.513-1(d)(2).

In administering the unrelated business income tax law, the Internal Revenue Service has long been familiar with the necessity to examine activities on a case-by-case, and even a category-by-category, basis. In Rev. Rul. 73-104, 1973-1 C.B. 263,

the Service concluded that the sale of greeting cards by a tax-exempt art museum did not give rise to taxable income where the greeting cards depicted works of art and, thereby, contributed importantly to the museum's exempt purposes of "stimulating and enhancing public awareness, interest, and appreciation of art." The Service reached that conclusion despite the "fact that the cards are promoted and sold in a clearly commercial manner at a profit and in competition with commercial greeting card manufacturers . . ."

Rev. Rul 73-105, 1973-1 C.B. 264, also involved the sales activities of a tax-exempt art museum. In that ruling, however, the museum not only sold items which depicted artistic works but also sold "scientific books and various souvenir items relating to the city in which the museum is located." In determining whether the museum's sales activities were subject to the unrelated business income tax, the Service recognized that it had to address each category of sales items separately:

> Thus, sales of a particular line of merchandise may be considered separately to determine their relatedness to the exempt purpose. Section 1.513-1(b)(2) of the regulations emphasizes that it is the particular facts and circumstances involved in each case which determines whether the activities in question contribute importantly to the accomplishment of any purpose for which the organization is exempt.

Applying these principles to the museum's sales items, the Service concluded that the items which depicted artistic works did not give rise to taxable income since those items contributed importantly to the museum's exempt purposes. Income from the sale of the scientific books and souvenirs, however, was determined to be taxable because the sale of those items did not contribute to the exempt purpose of enhancing the public's understanding and appreciation of art.

Thus, the Service has long recognized that application of the unrelated business income tax requires separate consideration of each aspect of a trade or business. In numerous private letter

rulings and general counsel memoranda, issued subsequent to the above revenue rulings, the Service has engaged in a category-by-category analysis when reviewing museum gift shop and hospital gift shop sales. Moreover, in those memoranda and rulings, the Service has stated that the difficulty of separating sales, category-by-category, is immaterial since the statute requires that each category be analyzed to determine taxability. Since the burden of proof is on the taxpayer, any duty to segregate ads by categories would be on the organization, not the examiner. Even this distinction becomes relevant only after the organization establishes that overall the advertising activity "contributes importantly" to the exempt function.

The government has offered no reason why advertisements should be treated differently from other activities, such as gift shop sales, other than the asserted fact that the IRS examiners have relied on a per se rule in regard to advertising. As has been demonstrated above, there is no legal justification for such a per se rule. The government's argument that the commercial nature of advertising must override the possible educational function of that advertising is of no avail. The greeting cards sold by the art museum in Rev. Rul 73-104, *supra*, were "promoted and sold in a *clearly commercial manner* at a profit and in competition with commercial greeting card manufacturers." Nevertheless, those sales were held nontaxable. The same treatment must be accorded advertising similar to that which is involved in the instant case.

CONCLUSION

For all of the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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